YAP SING HOCK HOLDINGS BHD. & ORS.

v.

CHUAH TEONG HOOI & ORS.

HIGH COURT MALAYA, KUALA LUMPUR
SITI NORMA YAAKOB J
[ORIGINATING MOTION NO. D2-32-36-1988]
17 FEBRUARY 1989

COMPANY LAW: *Section 67(1) of Companies Act 1965 - Debenture pledging assets of company present and future - As security for finance to purchase 3 private companies - Whether such transaction - Within s. 67(1) of the Companies Act 1965.*

The 1st applicant executed a debenture in favour of the 3rd respondent as one of the securities to secure 2 letters of guarantee provided by the 3rd respondent to finance the 1st applicant's purchase of 3 private companies.

Initially the 3rd respondent in consideration of its arranging the necessary syndicated loans from a consortium of bankers, required the 1st applicant to provide the following to secure the 3rd respondent's guarantee:

1. A pledge of all the shares of the 1st applicant to the 3rd respondent.
2. A deposit of title deeds of certain pieces of Land belonging to the 3 private companies together with charges-in escrow over them in favour of the 3rd respondent.
3. An assignment of all the proceeds of sale of the assets of the 3 private companies to the 3rd respondent.
4. Personal guarantees of the directors of the 1st applicant.

The 3rd respondent, acting on the legal advice of their solicitors to the effect that the securities asked for which are to be provided by the 3 private companies are illegal transactions as contravening s. 67(i) of the Companies Act 1965, finally agreed to the following as securities:

1. A pledge of all the 1st applicant's shares.
2. A debenture, creating a specific and floating charge of all its assets, both present and future.
3. Personal guarantees of its directors.

The first applicant defaulted payment of the loans when it was due and the 3rd respondent was called upon to repay under the 2 letters of guarantee. The 3rd respondent subsequently demanded immediate repayment from the 1st applicant. The 1st applicant failed to comply with the demand made and the 3rd respondent finally exercised its rights under the debenture to appoint the 1st and 2nd respondents as managers and receivers and took possession of all the charged assets and generally manage the 1st applicant's business.

The 1st applicant together with its directors and shareholders, the 2nd - 4th applicants after a period of 2 years and 4 months of the aforesaid appointment of managers and receivers have by way of originating motion, asked for a declaration - *inter alia* that the debenture executed by the 1st applicant with the 3rd respondent and the subsequent appointment of managers and receivers are null and void as contravening s. 67(1) of the Companies Act.

Held:

[1] Section 67 of the Companies Act 1965 is almost identical to s. 54 of the English Companies Act 1948. There are 2 elements in the commission of an offence under the English s. 54 that is firstly, giving of financial assistance and secondly the finance should have been given for the purposes of purchasing, dealing or lending money on its own shares.

[2] The words "giving financial assistance" have no technical meaning and one must examine the commercial realities of the transactions and decide whether it can properly be described as within the scope of the section i.e. each case must depend on the nature of the transaction involved.

[3] On the facts of the case, the creation of the debenture over the assets of the 1st applicant both present and future by the 3rd respondent to enable the 1st applicant to purchase the paid up capital of the 3 private companies, does not offend s. 67(1) of the Companies Act.

[4] In the Court's view, the only company that can be held responsible for contravening s. 67(1) can only be the 3 private companies purchased by the 1st applicant and not the 1st applicant. In order to bring the 3 private companies within the ambit of the section, it must be shown that the 3 companies provided financial assistance in the purchase of their own shares and it can only take the form of the 3 companies creating a debenture over their own assets in favour of 3rd respondent which is not the instant case.

[5] The 1st applicant upon the purchase of the 3 companies became the beneficial owners of all the assets in the 3 companies and can deal with such assets including charging them to the 3rd party respondent to secure the bank guarantees provided by the 3rd respondent. Therefore the debenture executed by the 1st applicant only covers the 1st applicant's assets whether present or future and not to the assets of any other company.

[6] The plea of promissory estoppel in that the 3rd respondent had by a course of conduct represented to the 1st applicant that it will not enforce the debenture was dismissed on the ground of insufficient evidence.

Cases referred to:

Charterhouse Investment Trust Ltd v. Tempeat Diesel Ltd [1985] PCC 466
Herald & Anor. v. O'Connor [1971] 2 All ER 1105

Legislation referred to:

Companies Act 1965, s. 67(1)
Companies Act 1948 [UK], s. 54

For the applicants - Subra Naicker; M/s. Subra Naicker & Co.
For the respondents - N.B. Naban; M/s. Skrine & Co.

JUDGMENT

Siti Norma Yaakob J:

The only issue raised in this originating motion is whether a debenture executed by the 1st applicant with the 3rd respondent on 29 April 1985 is caught by s. 67(1) of the Companies Act 1965, (the Act). The debenture in question is one of the securities provided by the 1st applicant to secure 2 letters of guarantee from the 3rd respondent to finance the purchase by the 1st applicant of the entire share capital of 3 private companies, namely Lien Hoe Sawmill Co. Sdn. Bhd., Tee Bros. Enterprises Sdn. Bhd. and Seng Aik Co. Sdn. Bhd. (the 3 companies) for a consideration of RM46 million.

To finance the purchase, the 3rd respondent arranged syndicated loans from a consortium of financial institutions (the lenders) backed by its own guarantees. Initially, the 3rd respondent required the 1st applicant to provide the following securities to secure the bank guarantees it was prepared to provide.

1. A pledge of all the shares of the 1st applicant to the 3rd respondent.
2. A deposit of title deeds of certain pieces of land belonging to the 3 companies together with charges-in-escrow over them in favour of the 3rd respondent.
3. An assignment of all the proceeds of sale of the assets of the 3 companies to the 3rd respondent.
4. Personal guarantees of the directors of the 1st applicant.

As regards repayment, the 3rd respondent had also requested that the sources for repayment should come from the cash fixed deposits and the proceeds of sale of the shares of the 3 companies.

However, acting on the legal advice that the securities asked for particularly those to be provided by the 3 companies are illegal transactions as contravening s. 67(1) of the Act, the securities that were finally given by the 1st applicant were (1) a pledge of all its shares, (2) a debenture, creating a specific and floating charge of all its assets, both present and future and (3) the personal guarantees of its directors, the 2nd - 4th applicants.

Under the debenture, the loans had to be repaid by the 1st applicant by 29 April 1986, failing which, the lenders would turn to the 3rd respondent for payment under the 2 bank guarantees.

The purchase price was duly settled by the 1st applicant on 29 April 1985 from loans extended by the lenders pursuant to 2 loan agreements executed by the 1st applicant with the lenders but on the date of repayment, the 1st applicant defaulted and the 3rd respondent was called upon to pay under the 2 letters of guarantee. It did so and in order to recoup its losses, it demanded immediate repayment from the 1st applicant and following the latter's failure to comply with such demand, the 3rd respondent exercised its rights under the debenture by appointing managers and receivers, the 1st and 2nd respondents on 9 May 1986 to take possession of all the charged assets of the 1st applicant and generally to do all acts which the 1st applicant may have done in the ordinary conduct of its business.

Two years and 4 months after such appointment, the 1st applicant together with its directors and shareholders, the 2nd - 4th applicants have, through this originating motion, asked for a declaration, *inter alia*, that the debenture executed by the 1st applicant with the 3rd respondent and the subsequent appointment of the 1st and 2nd respondents as managers and receivers under the debenture, are null and void as contravening s. 67(1) of the Act, which states as follows.

> Except as is otherwise expressly provided by this Act no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase deal in or lend money on its own shares.

Under sub-section (3), if there is any contravention of sub-section (1), only the officer who is in default shall be guilty of an offence, the penalty for which is imprisonment for two years or a fine of RM10,000 or both.

Our s. 67 is almost identical to s. 54 of the English Companies Act 1948 and in *Charterhouse Investment Trust Ltd. v. Tempest Diesel Ltd.* [1985] PCC 466, it was held that the 2 elements in the commission of an offence under the English s. 54 is firstly the giving of financial assistance and secondly it should have been given for the purpose of purchasing, dealing or lending money on its own shares. The case goes further to state that the words "giving financial assistance" have no technical meaning and their frame of reference being the language of ordinary commerce. "One must examine the commercial realities of the transaction and decide whether it can properly be described as the giving of financial assistance by the company, bearing in mind that the section is a penal one and should not be strained to cover transactions which are not fairly within it". In other words each case must depend on the nature of the transaction involved.

On the facts of this case, what the 1st applicant seeks to drive home is the fact that from its correspondence, the 3rd respondent had specially requested that the debenture shall cover all the assets of the 1st applicant both present and future. This is further confirmed by s. 3.01(i) of the debenture which states in no uncertain terms that the fixed and floating charge covers all the assets of the 1st applicant whatsoever and wherever situate both present and future. The applicants maintain that reference to the debenture covering assets to be acquired by the 1st applicant in *futuro* must mean the assets of the 3 companies, as at the time the debenture was executed, the assets of the 3 companies were the only certain and forseeable assets to be acquired by the 1st applicant. That being the case, the applicants maintain further that by means of providing their assets to be covered by the debenture, the 3 companies had given financial assistance to the 1st applicant in the purchase of their own shares. This renders the debenture illegal under s. 67(1) of the Act and consequently the appointment of the managers and receivers is null and void and unenforceable.

To support their contention, the applicants rely on the case of *Herald & Anor. v. O'Connor* [1971] 2 All ER 1105, where on the facts, it was established that a company had created a debenture over its own assets to secure a loan granted by the plaintiffs to the defendant for the purpose of enabling the defendant to purchase the company's shares. Under these circumstances, it was held that the debenture was illegal and void as it had contravened s. 54 of the English Companies Act 1948 which is almost identical to our s. 67.

The facts of the case before me are distinguishable from *Herald v. O'Connor*, in that the debenture was created by the 1st applicant who is purchasing the shares of the 3 companies. Reading s. 67(1) and applying it to the facts of this case, it is my considered opinion that the only company that can be held responsible for contravening the statutory provision can only be the 3 companies and not the 1st applicant and to bring the 3 companies within the ambit of s. 67(1), the applicants must show that the 3 companies provided financial assistance in the purchase of their own shares by the 1st applicant. On the facts of the case before me, that financial assistance can only take the form of the 3 companies creating a debenture over their own assets in favour of the 3rd respondent as did the company in *Herald v. O'Connor*. But this is not the case here, as the debenture was created by the 1st applicant, the purchaser of the 3 companies and the debenture covers the assets of the 1st applicant then in existence and those to be acquired in the future.

Admittedly the 1st applicant's future assets must include the assets of the 3 companies but in this respect, such acquisitions were perfected the moment the 1st applicant had paid for them. That was done at almost the same time, the syndicated loans were released to the 1st applicant and the debenture executed with the 3rd respondent. From that point of time by virtue of such a purchase, the 1st applicant became a shareholder of the 3 companies and being the beneficial owner of all the assets of the 3 companies, it can deal with such assets

in any way it thinks fit including charging them to the 3rd respondent to secure the bank guarantees provided by the 3rd respondent. Thus when reference is made that the debenture shall also cover all the future assets of the 1st applicant, it really means what it states i.e. that the debenture covers only the assets of the 1st applicant present and future and not to the assets of any other company.

On the facts of this case, it is my considered opinion that the creation of the debenture over the assets of the 1st applicant both present and future to secure the bank guarantees provided by the 3rd respondent to enable the 1st applicant to purchase the paid up capital of the 3 companies, does not offend s. 67(1) of Act.

The applicants have also pleaded promissory estoppel in that the 3rd respondent by a course of conduct, had represented to the 1st applicant that it will not enforce the debenture and the 3rd respondent is now estopped from appointing receivers and managers to manage the 1st applicant's affairs.

The course of conduct relied upon by the applicants are the negotiations between the parties to vary the debenture to enable the 1st applicant to put in more assets to secure the loan facilities. In this respect the applicants maintain that the proposals made at such negotiations had the effect of varying and nullifying the debenture as the applicants had acted on such proposals. The 1st applicant had pursuant to such proposals deposited all the title deeds of properties belonging to the 3 companies with the 3rd respondent, transferred its shares into the names of the 3rd respondent's nominees and that all other assets of the 3 companies have come under the control of the 3rd respondent.

The 3rd respondent denies there was any express undertaking or agreement reached that it will not seek to enforce its rights under the debenture in the event there was default on the part of the 1st applicant to repay the syndicated loans. Moreover, under s. 5.03 of the debenture, the 3rd respondent is empowered to appoint managers and receivers "at any time after the principal and other monies hereby accrued shall have become repayable". The 3rd respondent had made a demand to the 1st applicant on 5 May 1986 for which the 1st applicant was unable to comply and under s. 5.01 of the debenture, the security became enforceable under s. 5.02(a).

There is no oral evidence led in this case as the parties are content to rely on their own documents and the correspondence that had passed between them and since oral evidence could have resolved the existence or otherwise of any arrangement as regards the enforcement of the debenture and since in this case that it is not available, there is insufficient evidence based on the documents alone for me to arrive at the conclusion that the appointment of the receivers and managers was made in breach of some oral arrangement between the parties.

For the reasons I have given this originating motion must be dismissed with costs.

Also found at [1989] 2 CLJ 523